



FROM COUNSEL

A Preventive Law Service of The Office of The Judge Advocate General
Keeping You Informed On Personal Legal Affairs

Saving for College: Qualified State Tuition Programs— Section “529 Plans”

Qualified state tuition programs give tax breaks to taxpayers who save for college on a “pre-paid” basis. These programs are sometimes referred to as “529 plans” for the tax Code section that authorizes them. Funds contributed in a 529 plan are for future higher education costs of the designated beneficiary. Starting in 2002 these programs may be more appealing to military taxpayers.

Highlights:

- Beginning in 2002, education IRAs and 529 plans offer about the same income tax benefit - tax-free earnings if payouts are used for qualified educational expenses. Each, however, has a unique combination of benefits and limitations:
 - Education IRA: can be used for elementary and secondary school expenses, as well as college, but annual contributions are capped at \$2,000 per beneficiary, and an individual's contributions are subject to AGI phaseouts: joint filers with AGIs between \$190,000 and \$220,000 (\$150,000 and \$160,000 for 2001), and singles with AGI between \$95,000 and \$110,000.
 - Section 529 plan: distributions tax-free if used for higher education expenses.
- Starting in 2002, distributions are not taxed when used to pay qualified higher education expenses (e.g., tuition, fees, books, supplies, and required equipment, even reasonable room and board expenses of a student who is enrolled at least half-time).
- Accredited colleges, junior colleges, and area vocational schools are qualified to participate. In addition, accredited post-secondary schools offering credit towards a bachelor's degree, an associate's degree, a graduate or professional degree, or another recognized post-secondary credential, are eligible to participate.
- Taxpayers may claim a HOPE or Lifetime Learning credit and exclude amounts distributed from a 529 plan for the same student provided the distribution is not used for the same expenses for which a credit is claimed (no double benefit).
- The *contributions* made to the qualified tuition program are not subject to gift tax, except to the extent the contributions exceed \$10,000 annually (indexed for inflation). Beginning in 2002, if a distribution of earnings isn't used for qualified higher education expenses of the beneficiary, a 10% additional tax will be imposed on the distribution.
- In IRS Notice 2001-55, IRS announced a new policy that permits 529 plans to give participants the chance to change investment strategy annually. This should help 529 savings plans attract families who want more investment flexibility. Implementation is up to the individual state to change the program rules.

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Read more:

- Visit <http://www.savingforcollege.com> for general information about 529 plans.
- CNN Money: *Pros & Cons of 529 Plans*, http://money.cnn.com/2001/10/15/college/q_college/.
- *College Savings Plans by State*, from Kiplinger.com, <http://www.kiplinger.com/tools/managing/college/savings/2001/states01.html>. Also read, *Miracle Grow*, <http://www.kiplinger.com/magazine/archives/2001/September/managing/COLLEGE.html>.
- Smart Money University, *College Savings without the Tax Bite*: <http://www.smartmoney.com/consumer/index.cfm?Story=200106084>; *Tax-Wise Ways to Save for College*, <http://www.smartmoney.com/college/investing/index.cfm?story=taxwise>.

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